Association for Financial Markets in Europe

Call for Inputs Response

09/10/14

Wholesale Sector Competition Review

The Association for Financial Markets in Europe ("**AFME**")[1] welcomes the opportunity to comment on the Financial Conduct Authority's call for inputs on its wholesale sector competition review (the "**Review**").

AFME and its members are supportive of the initiative being taken by the new FCA Competition team to identify areas where competition may not be working effectively. AFME suggests, however, that any further work envisaged by the FCA must take into account all regulatory developments and their potential impact on competition and take careful account of where regulation may cause fundamental changes in market structure or dynamics.

Please note that while the views expressed in this response have been prepared by AFME in consultation with its members, they do not represent, and should not be construed to represent, the position of any one particular AFME member. Answers to specific questions are given below. Given the complexity and breadth of the Review, AFME may follow up with further comments.

Markets and market infrastructure

Q1: Taking into account regulatory developments in this area, we welcome evidence on any competition issues in the market for data services – in respect of both venue-traded and OTC products. For example:

- *Whether there are instances where those entities producing or disseminating data face limited competition such that they are in a position to charge higher prices and/or create barriers to entry or expansion.*

[1] AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the US Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Association for Financial Markets in Europe
London Office: St. Michael's House, 1 George Yard, London EC3V 9DH T: +44 (0)20 7743 9300 F: +44 (0)20 7743 9301
Brussels Office: Square de Meeûs 38-40, 1000 Brussels, Belgium T: +32 (0)2 401 8724 F: +32 (0)2 401 6868
Company Registration No: 6996678 Registered Office: St. Michael's House, 1 George Yard, London EC3V 9DH
www.afme.eu

It is widely accepted in the market that, despite the emergence of other sources of information with the introduction of competing trading platforms, that data from the primary exchange remains 'must have' and that other sources are not viable substitutes. AFME Members ("Members") share the view that there is no alternative to data from the primary exchanges and that data from the multilateral trading facilities is not a substitute. To a considerable extent, much of the data produced and disseminated by exchanges is effectively mandated by regulatory obligations and does not necessarily result from the exchange's own innovation and intellectual property. Investment firms in turn are effectively mandated by the same regulatory obligations to purchase this data, particularly to satisfy their obligations under the best execution rules.

Examples

Exchanges charge different fees depending on the customer type or how the data is used. For example, areas that may require further consideration may include, but not be limited to:

- Low latency data is generally charged at a premium.
- Data used for non-display purposes (e.g. in algorithms) may be charged for separately and/or fees may be imposed on certain software applications. For instance, an exchange may charge more where market data is used for a system checking price limits in the market (which it chooses to define as an algorithm) even though this price checking process is in place to serve best execution obligations.
- Data that is available from different devices may be charged for separately even if there is only one human user – which increases costs for customers.
- Exchanges often only sell bundles of different market data products rather than selling individual products. (For instance, it is not possible to purchase trading information on a specific company or set of companies nor just auction data separated from continuous trading prices.) As a result of this type of bundling Members are being forced to acquire and monitor data for which they have no use.

Why MiFID II may not solve the issues entirely

AFME acknowledges that MiFID II and current ESMA Level 2 proposals, in areas such as the European Consolidated Tape (ECT), data disaggregation and clarification of a 'reasonable commercial basis', seek to address some of these issues but it is AFME's view that these measures do not go far enough.

The ECT is intended to improve the quality and consistency of post-trade data; ensure that post-trade data is provided in a consistent and unambiguous format to remove scope for varying interpretations, allow comparison across venues and facilitate consolidation; and reduce the cost of post-trade data for investors by introducing standards for post-trade data and the introduction of an unambiguous comprehensive price regulated ECT. Of course, immediately it can be seen that the ECT will only address post-trade transparency and not pre-trade transparency, at least at the outset, and is not a comprehensive solution to market data transparency across the piste.

While ESMA's proposals seek to set out post trade identifiers, they do not go so far as to mandate adherence to the Market Model Typology (MMT) (a market standard for post-trade equity data). Current issues with quality, accessibility, format, content, meaning and cost of post-trade data would provide significant obstacles to simply and cheaply consolidating this data into a consistent, unambiguous, inexpensive ECT. Data quality issues should be addressed prior to publication as it should not be the role of the consumer, including the ECT, to interpret or translate the data it receives. AFME expects that ESMA's fixed list in this regard may also have its deficiencies in practice.

In relation to data disaggregation, while unbundling of post-trade and pre-trade data is mandated for venues in MiFID II, it does not seek unbundling of market data to the extent that would address the issues raised above. For instance, ESMA does not propose that consumers should be able to buy data only in relation to an individual instrument (DP Section 5.5, page 338, paragraph 6). AFME believes that users should have the option to purchase market data from exchanges (or from the ECT when established as long as the costs are reasonable) disaggregated at an instrument-by-instrument level.

Furthermore AFME remains unconvinced that the proposals put forward on the transparent disclosure by venues of their data pricing on a 'reasonable commercial basis' are sufficient. Insofar as enhanced transparency may act as a material break on increasing data costs, it may only incentivise the stabilisation of costs, and AFME would emphasise that neither just one, nor a combination, of the options provides adequate confidence that costs could decrease from the current high levels. In isolation from other measures this will not necessarily result in the desired reduction in costs. Additional transparency is a necessary but not sufficient condition to tackle excessive market data costs.

Market participants must be able to ascertain the variables used in the creation of the price being charged by the data providers. An important outcome of any transparency proposals will be to support competition generally.

It is our view that with the reduction of transaction costs, trading venues will come to overtly rely on market data revenue to buttress their income without being incentivised to improve service provision. Regulators should oversee the ability to set and cap fees set in other areas such as non-display usage or external redistribution to compensate loss of revenues from the introduction of the ECT.

In relation to the options presented by ESMA however, AFME considers that only a combination of options A (additional transparency) +B (publication of revenue share) +C (implementation of LRIC) combined with the FISD[2] exchange matrix, could supply exchange market data on a 'reasonable commercial basis'.

Q2: We welcome evidence on whether there are any competition issues in the market for trading and clearing services, both for OTC and venue traded products. For example:

- *Whether there are instances in which standalone trading venues and CCPs are limited in their ability to compete with silo structures.*
- *Whether there are instances of barriers to entry that prevent competition from new entrants.*

There may be certain instances in which standalone trading venues and CCPs are limited in their ability to compete with silo structures due to the naturally high cost barriers relating to default management. Clearing in the UK equity market is competitive as more than one CCP has access to the London Stock Exchange trade feed (interoperability). This is welcome and sets the standard for other European markets.

We are supportive of CCP competition for client clearing, which is already well established for equities, and under EMIR, is now available for OTC products. Customers are well served by a broad range of banks, acting as clearing members, offering bespoke services for their clients. We firmly believe that competition should be available at both CCPs and CCP clearing members and that it should occur on a level regulatory playing field, in order to minimise unintended consequences of potential regulatory arbitrage.

[2] FISD is Financial Information Services Division of the Software & Information Industry Association. In 2013 an FISD Exchange Working Group (with the following participants: Barclays; BOA Merrill; BNY Mellon; BBH; Capital Group; Charles Schwab; Citi; Credit Suisse; Deutsche Bank; HSBC Morgan Stanley; Northern Trust; Northern Trust; RBC; Scotia; State Street; TD Ameritrade; UBS; Wells Fargo) agreed a list of items it would like all exchanges to offer:
1. Per User pricing; 2. Direct reporting; 3. 3 year audit period; 4. Volume discounts; 5. Reasonable priced fixed fees (including Non-Display fees); 6. No charge for derived data; 7. Free of charge support and development users (within a reasonable percentage); 8. Fee waiver for DMA (direct market access); 9. Consultation on T&C's; 10. No subscriber agreements (the end user of the market data does not have to sign an agreement); 11. Clear reporting models (Simple reporting models (report the number of billable counts per product per billing account number)); 12. Enterprise coverage; 13. No indirect data feed charges)

We note that the cost of recent prudential regulations for clearing members is impacting the appetite for the business, raising clearing costs and reducing competition as clearing members withdraw, partially or wholly from this area.

Exchange listed products can only be cross-margined with cleared OTC products on the same clearing venue (i.e. CME treasury futures can be margined against swaps cleared on CME). As listed contracts are not fungible across venues, and the IP is owned by the exchanges, the resulting margin efficiency provides an incentive for market participants to clear OTC products where they are listed and vice versa, limiting potential competition in both areas. Although recent consultation on open access under MiFID II may address this to a certain extent there are concerns that allowing capacity constraints in the long term could be a basis for a CCP to deny access as a tool to avoid competition.

We strongly believe that clearing houses should not compete on risk management practices, for example through the acceptance of less liquid collateral. Further mandating client clearing may exacerbate the potential for this as clearing houses compete to attract previously non-cleared flow.

Whilst more competition across the market is generally to be encouraged, we would like to identify an undesirable consequence of excessive competition, which whilst not itself a limitation or barrier to entry, is relevant to discussion of competition for clearing services. Excessive competition amongst CCPs can cause CCPs to attempt to compete on risk management practices (for example through the acceptance of less liquid collateral) or to expand their clearing services to include products that are not suitable for unconstrained clearing (for example, those products that are constrained by limited liquidity, especially in a time of stress). This could increase the potential for CCP failure if the CCP has cleared too much of those types of risks that cannot be effectively managed, or if the CCP cannot liquidate collateral as required, at a time of member default (including the failure of those parts of their service that might otherwise have survived such a default event had more stringent standards been upheld). Further mandating client clearing may exacerbate the potential for this as CCPs compete to attract previously non-cleared flow. With multiple CCPs proposing to offer these products—as they must in a competitive regime— default of a common clearing member could result in the aggregate risk capacity of the market being exceeded as the various CCPs attempt to risk manage their defaulter's portfolios (even if each CCP's market capacity liquidation limits had been respected) and therefore compromising the more sound elements of their clearing services. This undesirable consequence of excessive competition could increase the potential for systemic risk, and seems unlikely to be consistent with the FCA's full range of objectives.

Q3: We welcome evidence on whether there are any competition issues in the supply of trading and clearing services by dealers. For example:

- *whether there are instances in which standalone dealers providing trading or clearing services are disadvantaged in competing with dealers that integrate such services*
- *whether there are instances of barriers to entry that prevent competition from new entrants*

No answer is proposed to this question at this stage

Q4: We welcome evidence on:

- *whether there are competition issues such as those noted above in the market for client clearing*

Notwithstanding our comments on client clearing in the equities space in the response to question 2 above it is worth noting that client clearing will change markedly when client clearing obligations are introduced in 18-36 months. It is not certain how many providers there will be, not least because the ultimate scope of the clearing obligation, or which CCPs will be available for clearing, is unknown at this stage.

Q5: We welcome evidence on whether there are any competition issues relating to concentration in the OTC and/or venue-traded markets. For example:

- *whether there are ways in which the markets are structured or function (taking into account the expected impact of regulatory developments) that discourages competition from potential new entrants, or competition between incumbents*
- *whether there are any competition issues that arise from the lower levels of transparency in the OTC markets relative to the venue traded markets*

We are not aware of significant barriers to entry or exit beyond the natural need for building networks of trading relationships. Pre-trade transparency information is widespread, with market makers generally disseminating quotes through electronic trading venues and readily responding to requests for quotes both electronically and bilaterally (off-venue).

The corporate bond market is largely over-the-counter, where dealers and brokers play an active role as liquidity providers. Market forces and growing transparency have enhanced competition in the fixed income market in recent years. Pre-trade transparency, to the extent that it does not discourage market makers from providing liquidity, is particularly widespread. For example, pre-trade market data on bonds is available through a number of sources to all market participants or to any other users from the commercial pricing providers, encompassing available information such as quotes, indicative prices, executable prices, firm prices and volumes. Investors, in general, may have more pricing data available to them than the dealer market participants as they receive prices from multiple providers.

Market participants are free to enter and exit the market. It is common to trade corporate securities with access to over one hundred market makers displaying quotes on trade platforms like Bloomberg on a regular basis on a significant number of bonds. AFME would be happy to follow up with additional data and information on this topic, should it be required.

Currently, fixed-income market making depends on the ability to respond to multiple markets, orders and client conditions. The one-to-one RFQ model ensures that market makers can offer effective pricing for a particular product, order size and settlement risk in the market conditions at that time, also enabling the market maker to effectively hedge their subsequent risk. The introduction of requirements that disincentivise provision of prices to all clients by increasing risk to market makers could decrease market demand as well as the overall marketplace diversity, reducing effective competition and increasing volatility, especially during times of stress.

Fixed income markets support multiple trading venues with differing levels of access to facilitate liquidity. For example, certain interdealer venues make certain requirements such as restricting membership to credit institutions and financial services providers, or minimum liable equity capital to become a clearing member to guarantee the suitability of the liquidity provider. In the European sovereign debt market, interdealer brokers are formally recognized as such and are only permitted to allow access to registered Primary Dealers. However, these arrangements are the counterpart to obligations undertaken by primary dealers including, for example, an obligation to quote a market to clients on request, an obligation to stream prices into interdealer venues, and primary market participation obligations. Primary dealers require these interdealer venues, where counterparties operate under similar or identical obligations, in order to effectively discharge their primary dealership obligations, service their end-user clients and provide primary market liquidity to sovereign issuers.

MiFID II/MiFIR provisions currently under level 2 discussions will expand further pre- and post-trade transparency. The industry has welcomed the intention to expand transparency in the market although has expressed concern that an inadequate calibration of the various MiFID II/MiFIR provisions and an inappropriate application of the requirements to illiquid instruments or large transactions could discourage market makers from providing liquidity to their end users clients, and therefore prevent further competition in the fixed income market. Please find AFME's response to MIFID II/MiFIR level 2 consultation paper in http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=11415 and discussion paper http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=11416 where we provide a more comprehensive description of our position regarding the effects of excessively onerous transparency requirements, such as preventing Systematic Internalisers from hedging or unwinding their positions by mandating disclosure of their identity, or inappropriate volume disclosure of large transactions, among other excessive provisions.

From a fixed income perspective we are concerned that the business model and competition of market makers, who support market liquidity, is at risk through future regulatory proposals that increase fixed and operational costs Examples of such are increased costs as a result of proposed transparency requirements as per MiFID II/MiFIR; increases in capital, liquidity and leverage requirements; restrictions on holding inventories in response to Bank structural reforms such as Volcker and European rules; requirements to execute through venues where high frequency traders have better access than genuine customers; and inconsistent national regulatory regimes with extraterritorial impact being applied to global markets. These challenges collectively impact the business model of traditional market makers resulting in a number of banks reducing their inventories.

Q6: We welcome responses on whether there are any competition issues associated with co-location.

Providing that ESMA fulfills its MiFID II mandate to ensure that colocation services are provided in a transparent, fair and non-discriminatory then AFME believes that any current competition issues in relation to colocation will be resolved.

To ensure that transparent, fair and non-discriminatory co-location services are offered by trading venues, a regulator would consider the following factors:

a. Non-discriminatory pricing:

Trading venues must publish or make available on demand their commercial policy including the list of prices as well as the objective conditions for accessing the co-location services. In evaluating reasonableness, trading venues should offer services:

(i) with rates that are not so prohibitive that only a small percentage of members who might benefit could afford them;

(ii) that are priced comparably to similar services offered elsewhere in the market and do not unreasonably benefit from a trading venue's unilateral control over their own data, facilities, etc; and

(iii) services should be available on a standalone basis not as bundled packages that may discriminate between market participants.

b. Transparency of data centre agreements:

Trading venues should make available clear documentation about their products and services with all relevant information including pricing. Under no circumstances should trading venues be allowed to inform only certain market participants of the existence of certain services. The fees charged to market participants must be uniform between market participants using the same services and should not discriminate against different classes of market participants – they should offer their services to all qualified participants on identical and transparent terms. Allocation and availability of data centres should be fair, as should a markets participant's usage there of, and the trading venue should not be able to apply restrictions on usage.

Q7: We note that certain types of market and market infrastructure have been subject to previous competition scrutiny via the mergers regime. Are there grounds for revisiting any of the competition issues previously considered?

No answer is proposed to this question at this stage

Investment banking

Q8: We welcome comments on whether bundling of investment banking services distorts competition

We consider that there is appropriate competition in corporate advisory services and in underwriting services. We note that the last several years have seen a reduction in fees which is not the expected outcome where competition is absent or weak. We have also seen an increase in the number of banks competing for business along with new independent advisors and boutiques advising issuers which indicates increasing competition. Finally, in our members' experience there is substantive discussion about costs and the quality of services with issuers and their other corporate advisors

Q9: Taking account of the work already carried out in this area and the MiFID II developments, we welcome evidence on:

- *whether there are reasons to revisit competition in equity underwriting (including IPOs), or*
- *the need for similar analysis of the market for debt issuance*

Given the OFT review of rights offerings and follow-on capital raisings conducted in 2011 which resulted in a decision not to refer matters to the Competition Commission and given the fact that a number of the OFT's recommendations have been successfully taken-up by issuers, it seems that another review of underwriting processes need not be a priority at this time. For example, in the UK the use of independent advisors by some issuers has grown which in those cases has resulted in larger syndicates and much more issuer involvement in the allocation process. As a recent FT article has noted, private equity firms now have underwriting licenses and there has been experimentation with auctions which increases competitive pressures greatly.

AFME defers to ICMA to comment on the need for similar analysis of the market for debt issuance.

Q10: We welcome evidence of how competition is working in the market for client order execution – in particular evidence on:

- *how clients monitor delivery of best execution*

- *how brokers compete for clients*
- *Responses should take into account the impact of MiFID II and other regulatory changes.*

AFME notes the recent publication of the FCA's findings on its Thematic Review of Best Execution, which are being considered by AFME members. AFME may follow up with further comment in this area in due course.

Asset Management

Q11: We welcome evidence on whether:

- *sufficient incentives exist for asset managers to negotiate the best deal for investors in relation to areas such as:*
  - *governance services*
  - *transfer agency*
  - *dealing commission and research (including evidence on how competition is working among providers of research)*
  - *other ancillary services, such as stock lending, transitions, custody or foreign exchange services*
- *Investors are able to assess effectively the quality of the asset managers' negotiations or are able to gain sufficient assurance that appropriate governance arrangements are in place.*
- *There are other activities where the incentives of the asset manager and the client may not be aligned and where competition is not aimed at satisfying the needs of the investor.*

Responses to this review may touch on issues addressed in the context of the FCA's thematic work on dealing commissions which will be published shortly. Where we receive responses relating to dealing commissions we will work closely with the thematic review team to ensure that these are considered together and that we are not duplicating work.

Focusing on the use of dealing commission to purchase research and drawing on our response to section 2.15 (legitimacy of inducements) of the ESMA CP/2014/549 on MiFIDII/MiFIR and on our draft response to the FCA DP14/3 on the use of dealing commission regime, we set out below our response to Question 11.

The provision of research to the asset management industry has evolved over the first two decades of this millennium from a bundled model to a mature unbundled world where execution and research services are disaggregated via the use of Commission Sharing Agreements ("CSAs"). This ultimately benefits the end investor (the consumer). CSAs allow for multiple research providers to be paid whilst also satisfying best execution requirements, as shown in the diagrams in Appendix 1. CSAs also help to lower barriers to entry into asset management by allowing newly established asset managers to consume research before taking investment decisions (and therefore generating dealing commission), rather than being forced to commit large sums to purchase research before investment and therefore returns. The availability of research through CSAs also increases competition amongst asset managers, by allowing smaller asset managers to buy in expert opinions, through externally sourced research, rather than having to rely on internal research departments, which only bigger asset managers can do.

CSAs are used extensively in the UK. A Greenwich Associates census[3] of UK asset managers over the 2011-2014 period, demonstrates that over 70% have CSA arrangements in place. The Greenwich data also shows that UK asset managers use a significant number of separate research providers but that this number is decreasing. While the number of brokers used by asset managers for research purposes was stable in 2011 and 2012 at ca. 32 providers per manager, this number has decreased in the last two years and is now 25. The decline can,

[3] Greenwich Associates 2014 European Equity Investors Research Study

inter alia, be ascribed to shrinking commissions and to market anticipatory reaction to the FCA policy intent to ban the use of dealing commission to pay for research. CSAs facilitate choice between research providers and have allowed a wide range of research to emerge by allowing consumers of research easy access to the research products of smaller houses.

Investment managers regularly negotiate on execution rates within the CSA and exercise high levels of governance around those rates.

It is also germane that in most instances investment banks are price takers. Price-taking is an indicator of intense competition in a market.

If research cannot be paid for via dealing commissions, as is proposed by the FCA and by ESMA, we expect there would be significant and negative effects on the provision of research and thus fund interests and returns. Research constitutes a valuable service to portfolio managers and funds, because they enable portfolio managers to make better investment decisions, which ultimately benefit the fund. If research cannot be paid for via dealing commissions, there will be substantial international divergence as to how research costs are charged and disclosed in the UK and EU to the detriment of UK/EU portfolio managers, whose annual management charges will be inflated compared to non-UK/EU managers, hence adversely biasing the comparability of their services' costs and accordingly affecting consumer investment decision and choice.

Portfolio managers would need to find an alternative way of paying for research. This could include:

- increasing management fees to cover the costs;
- paying for research via operating expenses; or
- charging funds separately for research.

Some of the potential costs, and detrimental consequences, to funds are outlined below.

Creating a competitive disadvantage for European portfolio managers

Given that research is an essential service assisting portfolio managers in the performance of their core function and that research, like execution, is a service used for the benefit of the fund rather than the portfolio manager, we expect that the cost of research is likely to be passed on to funds, probably through the annual management charge ("AMC"). While the AMC represents only part of total asset manager costs, it is used internationally to compare those costs. On this basis, any increase in AMC is likely to place UK/EU asset managers at an optical competitive disadvantage and lead consumers to select non-UK/EU managers that are in reality offering a higher total cost service.

Analysis of the UK market suggests that the increase in the AMC arising from incorporating the cost of research could be ca. 7bps, rising to 9bps if research payments are subject to VAT. This figure is based on the AMC increase being the same as an implied research payment of £1.04bn (£1.25bn with VAT) divided by the estimated active equity mandate assets under management (AUM) of £1,463bn. A worked calculation is set out at Appendix 2.

In theory, the impact of moving research costs from dealing commission to AMC should be neutral to the end investor. But investors, and retail investors in particular, focus on AMCs when comparing the costs of portfolio managers and often use these as the key point of comparison between managers. As a result, it would appear to investors that a UK/EU portfolio manager running an identical fund to a US manager is charging a higher AMC, thus placing UK/EU portfolio managers at a competitive disadvantage. Furthermore, the gap in AMCs charged by actively-managed funds would widen as compared with passively-managed funds.

Given that investors are naturally very focused on driving costs down (and in some cases have a fiduciary or legal duty to demonstrate such a focus on costs) there would be a strong incentive to switch their funds away from European portfolio managers to US portfolio managers, where the management fees are likely to be lower.

There will also no longer be a common point of comparison between the relative costs of portfolio managers on a global basis; UK/EU managers' costs methodologies will be out of step with the way the rest of the world both charges and discloses costs. Given that this will be a competitive advantage for non-UK/EU managers, there will be little incentive for non-UK/EU jurisdictions to change their regulatory regimes to come into line with UK/EU. Contrary to what the FCA suggests in DP14/3, there has so far been no indication that other jurisdictions are considering changing the way that their managers pay for research, and we note that such change would require significant political motivation to do so given that it would require legislative change in, e.g. the US.

This will make it difficult for UK/EU portfolio managers to compete in the international marketplace, particularly for international mandates, and will likely result in a reduced choice of funds and portfolio managers available to the UK/EU consumer. Portfolio managers who manage products out of both the UK/EU and the US will likely move operations to the US, given the competitive advantage of doing so. UK/EU-managed products may also be less attractive to US consumers, as a consequence of higher headline costs.

Disproportionate impact on smaller portfolio managers

The current system has low barriers to entry for new/small portfolio managers. By contrast, the FCA (and ESMA) proposals for research funding would erect considerable barriers to entry in the form of the high start-up costs which would result from paying for research out of profit and loss.

The combined effect of raising barriers to entry for smaller managers, and of encouraging funds (including very large pension funds and sovereign wealth funds) to switch their funds to non-UK/EU managers to avoid apparently higher fund management fees, is likely to have a materially detrimental impact on investment within the UK/EU and consequently upon economic growth in the region, as well as reducing customer choice.

Increased operating costs for portfolio managers

An alternative to passing on costs of research in the AMC would be for managers to absorb the research costs into their operating costs. Based on the above analysis, this could represent between 30-40% of operating margins. Whilst large managers might be able to absorb these costs, and global managers might be able to restructure their businesses to minimise the impact, smaller UK/EU managers would be less able to so. They may as a consequence reduce the levels of research consumed, to the detriment of end- investors or, in extreme circumstances, cease business thus reducing consumer choice. This could result in a contraction to the UK/European investment management industry; it could also encourage capacity to move to the rest of the world.

Imposing high fixed costs on UK/EU managers would increase their operational leverage relative to non-UK/EU peers and make them more vulnerable to the effects of any future economic downturn, creating additional risks for funds managed by such managers, risks that investors in funds outside the UK/EU would not face.

Fewer smaller independent research providers

One consequence of a potentially reduced funding pool from UK/European portfolio managers for research services would be less independent research content and diversity, as a result of consolidation. Smaller boutiques would struggle to sustain their business models as portfolio managers, facing increasing pressure to cut their costs, and further seek to consolidate their research and execution broker lists. It is not the case that research is over-produced. All research reports are read by someone in asset management, and all analysts receive some broker votes.

Less diverse research coverage

Service providers may choose to restructure their businesses and concentrate resources on the production of research on blue chip companies, as opposed to SMEs. This could potentially result in less unique and contrarian research being produced, whilst leading to a reduction of the coverage universe. This reduction of coverage would result in a less well informed market and could ultimately impact small and medium European enterprises as they seek to grow through raising capital; less research coverage is in turn likely to result in less investment in these enterprises by European portfolio managers.

A similar effect is likely to be seen on emerging markets research. Both SME coverage and emerging markets research coverage tend to be provided by specialist/local analysts. A move in the market to favour larger research providers, who are able better to absorb the increased operating costs, would see fewer small independent research providers covering these areas, which will likely be considered unprofitable.

Due to the cyclical nature of sectors and geographical regions, research providers currently maintain a service covering of areas that may not at a specific point in time (for example in a downturn) be a key area for investment by portfolio managers. However, the advantage of maintaining coverage in these areas for the end investor is that when the area in question does become a viable investment opportunity then valuable research and expertise is available. Under the FCA and ESMA proposals, research providers would be less able and less likely to maintain continuous coverage and due to the nature of research production (expertise is built up over a period of time as opposed to acquired instantaneously) are unlikely to be able suddenly to cover such areas.

Removal of incentives to improve the quality of advisory resources (as a consequence of the reduction in the open, competitive nature of the market for research advice) would also result in a lower quality of research available to portfolio managers, and ultimately lead to less well-considered investment decisions for investors.

Procurement of US research

UK and EU managers and their clients will be disadvantaged relative to managers and clients in other jurisdictions because US brokers may refuse to provide them with research in exchange for cash payments because of uncertainties under US investment adviser law. Even if US brokers were willing to accept cash payments and submit to investment advisor regulation over their research, the latter regulation would result in these brokers limiting their transactions with UK/EU managers and their clients to agency transactions. This would deprive those managers and their clients of capital commitment, volume-weighted average price and other transactions effected on a principal basis via a broker providing the research, and also of investments sold on a dealer-only basis, thus forcing those managers and their clients into the possibly less favourable agency markets for those investments and, therefore, potentially jeopardising best execution.

If UK/EU managers are prohibited by UK/EU regulation from paying for US research from commission , and US broker/dealers cannot in practice accept cash payments for research under US law, this would make it impossible for a UK/EU-based manager to procure US research, which could result in UK/EU managers being unable to procure such research other than from registered investment advisers or UK/EU producers of US research. This could lead to a significant reduction in choice of the research being procured for end investors.

This would also make it less economically viable for UK/EU providers to publish research on US companies or macro-economics; meaning less US research, at higher costs, for UK/EU consumers and potentially poorer performance for UK/EU managers of US assets. As a consequence, it would be more difficult for UK/EU investors to access US markets, given that UK/EU managers will reduce US mandates under management. UK/EU consumers will be left with less choice of funds providing exposure to US markets, and with higher risk, as most of the investment options available will be managed by US managers, thus leaving those UK/EU consumers without the protection of the UK/EU regulatory regime.

Q12: We welcome evidence on whether the bundling of ancillary services provided by intermediaries to asset managers is in the interests of funds and investors. In particular:

- *whether the pricing pressure on some services has made it un-economic to provide certain services on a stand-alone basis, making it necessary to bundle*
- *whether pricing pressure affects the quality of the service being provided*
- *whether the bundling business model deters new entrants from competing in the market for ancillary services*
- *whether any benefits of bundling are passed on to the fund*

No answer is proposed to this question at this stage

Q13: We welcome evidence on reasons for the differences in charges between retail and institutional funds. In particular we would like to understand:

- *the extent that this is due to economies of scale*
- *the extent to which volume discounts are available*
- *the effectiveness of governance for retail funds relative to institutional funds*
- *the role of investment consultants in relation to fund charges and governance and the effectiveness of competition between investment consultants*

No answer is proposed to this question at this stage

Corporate banking

Q14: We welcome evidence on whether:

- *There are competitive or regulatory factors that affect the likelihood of new competitors undertaking corporate banking services, or affect the ability of existing competitors to expand.*
- *Issues that the OFT has discussed in relation to SME banking apply equally to larger corporate clients.*
- *Cross-selling has an impact on firms' ability to compete, either in relation to corporate banking services or in relation to other services such as investment banking services.*

No answer is proposed to this question at this stage

Next steps

Q15: We welcome evidence on any other areas where competition is not working effectively in the wholesale sector. In particular:

- *exploitation of market power, including exclusionary behaviour.*
- *barriers to entry*
- *barriers to switching*
- *problems in the flow of information, and/or*
- *principal/agent problems and conflicts of interest*

A. Auction Pricing

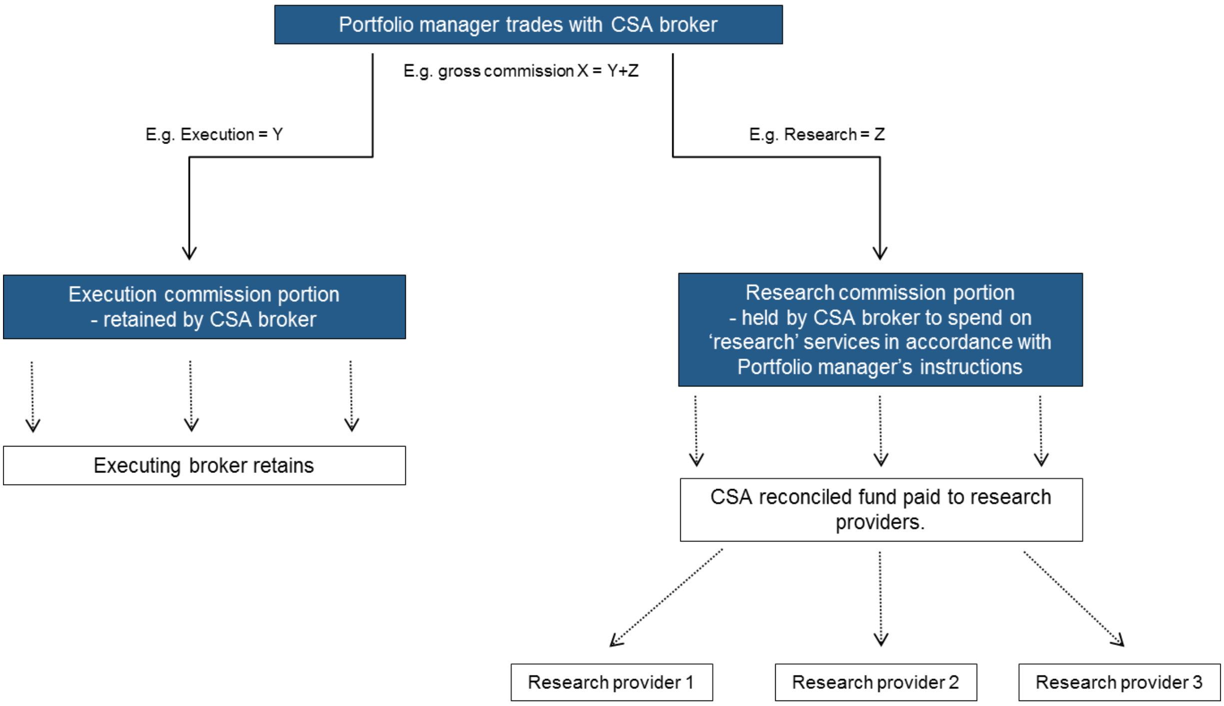
While continuous trading in equity instruments may be available in several trading venues, the auction trading period remains almost entirely confined to one venue – usually the primary venue of listing. Opening and closing auction market data tends not to be split out from market data relating to the continuous trading period.

B Data Vendor Messaging

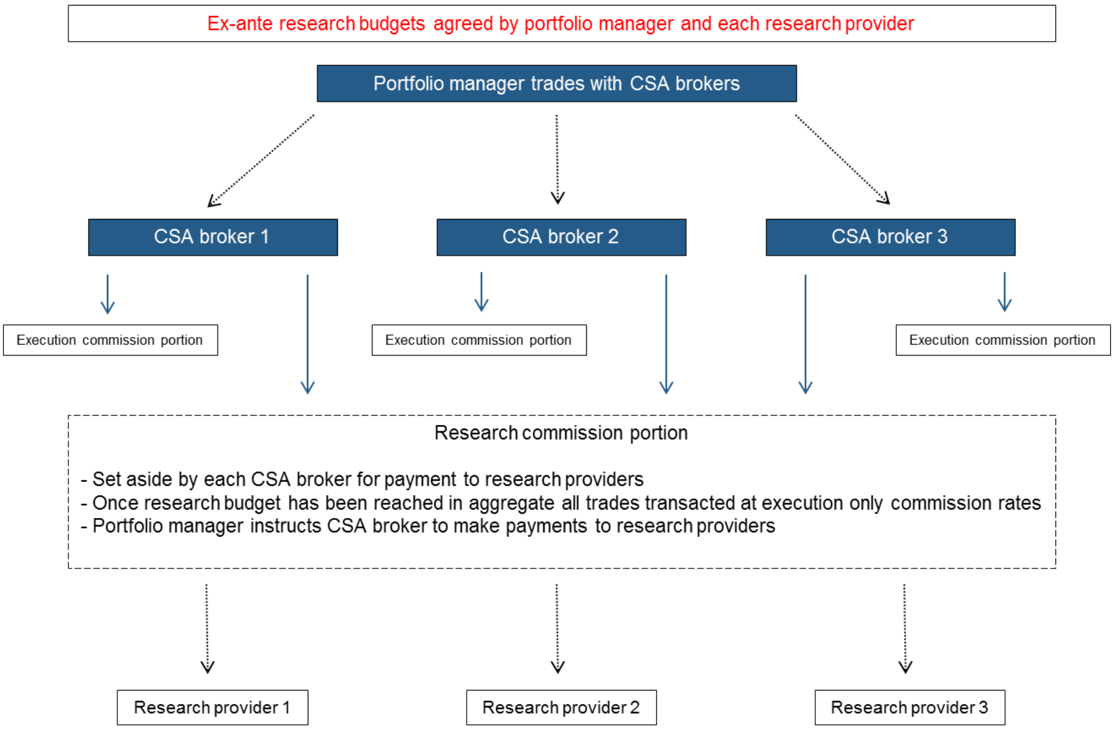
Instant messaging remains a closed protocol embedded within the workstations supplied by the data vendors. The service is neither interoperable nor available to be consumed as an unbundled service which forces Members to buy bundled and inappropriately priced market data services that may otherwise not be required or may be available more competitively elsewhere.

Appendix 1

Current CSA Model



Proposed Enhanced CSA Model



Appendix 2

Question 11 Worked Calculation

AUM (end 2012)	£4,459 bn	(IMA Annual Survey 2012-3)
Equity content	42%	(IMA Annual Survey 2012-3)
Implied equity assets	£1,873 bn	
Active	78%	(IMA Annual Survey 2012-3)
Active equity AUM	£1,463 bn	
Turnover	1.2x	
Commission rate	11bps	(Greenwich Associates European Equity Investors 2013)
Implied commissions	£1.93 bn	
Research allocation	54%	(Greenwich Associates European Equity Investors 2013)
Implied research payment/ increased AMC	£1.04 bn, or 7bps on £1,463bn	
VAT on which @ 20%	£0.21 bn	
Total implied research payment/increased AMC	£1.25 bn, or 9bps on £1,463bn	